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SUBJECT: AIRBUS GROUNDED BY POWER8 AND THE DOLLAR?

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11. (U) SUMMARY: Airbus, the renowned producer of the new A380 super jumbo jet, is one of the largest and most publicized firms in Europe. The civilian and military aircraft manufacturer has struggled to stay ahead of its competitor Boeing amid a corporate restructuring program, an executive scandal, production delays, and a weak U.S. dollar. While Airbus is certain to remain a major player in the aerospace industry, how the corporation shapes its structure over the near future remains open. Further changes will affect stakeholders across Europe, including US suppliers. END SUMMARY.

EADS RESTRUCTURING AMID SCANDAL

12. (U) The European Aeronautic Defense and Space Company (EADS) consists of five divisions, including commercial airplane manufacturer Airbus, that represent every segment of the aerospace industry. Louis Gallois is the new CEO of EADS, while Dr. Thomas Enders manages Airbus. EADS also possesses a rather unique capital structure. The French State and media/technology firm Lagard'ere control 27 percent of equity; German Daimler Aerospace and other affiliated investors control 22 percent; and SEPI, a Spanish holding company, controls five percent. The German state does not own any portion of the company, but politicians have assumed a significant role in EADS' development. These divested financial stakes originally stemmed from the merger of French, German, and Spanish aerospace companies in 2000 that created EADS. In fact, two people - one German and one French - shared the role of CEO until Chancellor Merkel and President Sarkozy agreed upon the firm's current leadership structure in 2007.

13. (SBU) Shortly after this milestone in EADS history, reports of corporate fraud began to surface. The media reported that EADS CEOs Gallois and Enders (before leadership changes) and the company's largest investors (Daimler and Lagard'ere) sold EADS stock between November 2005 and November 2006 based on insider knowledge. The parties are accused of profiting from privileged information about potential production delays of Airbus' newest model, the A380. German and French authorities continue to search for substantive proof amid a myriad of claims, but so far, investigations have failed to substantiate the allegations. EADS reported 2007 third quarter losses of 696 million Euros (1 USD billion). (Note: A senior EADS contact close to Tom Enders expressed skepticism over the motives of the French investigation into Enders' actions, telling ConGen Munich that the manner in which this "old story" was illegally leaked to the press, made it difficult to exclude that certain circles in

France had an interest in damaging Enders' reputation. End Note.)

THE NEW LEVIATHAN

¶4. (U) For decades, Boeing dominated the aviation market with the 747, until recently the world's largest civilian aircraft. The 747 led long-haul commercial aviation for decades. For the last few years, however, Airbus penetrated the market with a series of new airplanes, including the revolutionary A380.

¶5. (U) The A380 is by no means a simple machine. It measures 240 feet in length, 80 feet in height, and weighs about 400 tons without fuel. The airplane's wheel base alone takes up 100 ft of space on the runway. Furthermore, the A380 has two cabin decks (i.e. levels), from nose to tail, that are capable of transporting 555 passengers distances ranging up to 9,400 standard/statute miles. From wingtip to wingtip, the plane spans nearly the length of an American football field (79.8 meters). In comparison, Boeing's present 747 (type 400) model has a much shorter upper-deck, carries roughly 400 people, and travels a maximum of 7,700 standard/statute miles. And the A380's size is just one manifestation of the airliner's capabilities and engineering sophistication.

A GLOBAL AIRCRAFT

¶6. (SBU) Like several other Airbus aircraft, the A380 is manufactured in different facilities across Europe. Seven of the sixteen Airbus European regional facilities are located in Germany and employ alone around 20,000 people. (Note: Including its subsidiaries in the U.S., Japan, and China, Airbus has a total number of approximately 57,000 employees. End Note.) Six of these factories are located in Northern Germany, producing a variety of components and assembling fuselages (cylindrical mid-sections) and cabin sections. Hamburg is the largest of all the German factories and constructs portions of the A320 and A380 aircraft. Sections and other materials are transported between sites regularly, but Hamburg often operates the final assembly process. The A380's interior cabin sections,

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for example, arrive from Laupheim during the final stages of production.

¶7. (SBU) During a December 11 visit at the Airbus factory in Hamburg-Finkenwerder by Hamburg CG and Berlin EMIN, Airbus Deutschland General Secretary David Voskuhl estimated that about forty to sixty percent of the A380's materials are purchased from suppliers in the United States. This varies according to the aircrafts' specifications. Engines purchased from American companies, such as General Electric or Pratt & Whitney, consist of parts from around the world and contribute to the difficulty in identifying an airplane's absolute composition.

POWER 8 RESTRUCTURING

¶8. (U) The production of the A380 was delayed in 2006 due to the company's underestimation of the aircraft's immense electrical and structural needs. This led to a drastic change in Airbus' operations and earnings, especially in light of the weakened U.S. dollar. The firm immediately embarked upon a four-year corporate restructuring program in 2006 entitled "Power8." The financial plan calls for a reduction in overhead and supply costs, faster product development, leaner manufacturing processes, and improved customer service. Power8 was unanimously accepted by the EADS board of directors in February ¶2007. The company aims at recovering five billion Euros by 2010 and an additional two billion Euros in 2011. Already, Airbus has cut the manpower needed to complete an A380 in Hamburg by about one-fourth.

¶9. (U) Adhering to the Power8 strategy requires Airbus to recover nearly 32 percent of its earnings before interest and taxes (EBIT) through the elimination of 10,000 jobs across Europe, including 3,700 in Germany. According to the firm, half

of these positions are temporary or sub-contracted. Nevertheless, the future job cuts have outraged local politicians, unions, and their members, who assert the firm is trying to implement an easy solution to a much larger issue. Stakeholders in affected countries, especially Germany, continue to lobby their local and national governments to protect their interests.

¶10. (U) The Power8 model also focuses on "core businesses" and long-term partnerships because Airbus anticipates the need to grow in key competencies relating to the industry. According to CEO Gallois (EADS), these consist of elements "that are essential to design, develop, produce, deliver, and support the best and most efficient products" for the customer. "If we move carefully, pragmatically, and quickly," he says, "we will leverage our position as a leading global player in the civil airliner market." To decrease further costs, Airbus also plans on developing a "consolidated supply base." This includes partnering with major industrial firms and suppliers that will help or take over some of its manufacturing and engineering processes.

A TOUGH SELL

¶11. (SBU) Although Airbus has received interest from several suppliers willing to purchase a number of its production sites, closing the deal has been rather difficult. Six of the sixteen European factories, including Nordenham and Varel in Lower-Saxony, Germany, are presently available for full or partial acquisition. In a conversation with Airbus representatives in the spring of 2007, Hamburg Pol/Econ Officer asked why Airbus was willing to sell these plants after having invested in making them centers of excellence. The Airbus rep responded that the plants would continue to specialize in their areas of expertise and Airbus would contract with them, thus cutting overhead costs - i.e. creating "core businesses." In the December 11 meeting, Voskuhl explained that Airbus, like all companies, is in the process of finding the balance between contracting out and maintaining control over production. He implied that by selling some of the Northern German plants, the company would be saving costs and yet still maintain its high levels of quality control.

¶12. (U) Airbus originally favored the interest of Voith Locomotive Company from Kiel, Schleswig Holstein because of its locality and manufacturing expertise for the Lower Saxony plants. In October 2007, Voith explained it no longer was interested due to concerns about profitability. Consequently, there are only two remaining bidders, OHB/MT Aerospace and Spirit Aerosystems. While both firms are well positioned to acquire any of the sites, locals favor the Bremen-based aerospace technology company, OHB. Supporters suggest that maintaining German influence may secure domestic interests, solidify the supply chain, and prevent a communications gap with the parent firm.

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¶13. (U) Spirit is a major supplier to the civil aviation industry and appears to fit the Power8 model exceptionally well, but it is a U.S. firm that happens to be a supplier of competitor Boeing as well. Stakeholders fear a conflict of interest and disapprove of an acquisition by a non-European company that may implement further job cuts. On December 10, CEO Thomas Enders stated the company requires more time to evaluate offers for the factories and will not make a decision until early 2008.

THE FUTURE OF AIRBUS

¶14. (U) Despite the two year-long production delay of the A380, Airbus remains a strong player in the aviation industry. The first A380 delivery to Singapore Airlines in October 2007 prompted a sigh of relief among Airbus executives. In 2006, Airbus received 844 total aircraft orders, including 165 for the new A380 model, valued at 75.1 USD billion. Airbus recently

secured a contract for 160 of its aircraft with the Chinese Aviation Industry and is trying mightily to crack the Japanese market.

¶15. (U) Still, securing more orders is only getting tougher. Boeing's rival 787 "Dreamliner" grabbed the media spotlight with its July premiere. The airplane's fuel efficiency and flying range surpass that of its Airbus counterpart, the A350, which Boeing credits to its incorporation of 50 percent composite materials (e.g. carbon-based) in the airplane's wings and fuselage structures. The company reports 740 orders from 51 customers.

¶16. (SBU) Apart from competition, other difficulties continue to plague the struggling EADS division. Power8's five-to-seven million Euros in savings was based upon an exchange rate around 1.30 USD in late 2006. Airbus pays its expenses in Euros, but most of its transactions for airplanes are quoted in U.S. dollars. At 1.50 USD to the Euro, Airbus calculates it will need to increase its Power8 savings goal between 2.1 and 3.1 million Euros. This will require drastic measures, including further job cuts. When questioned in December 2007 if the firm will adjust its selling prices, Airbus Deutschland General Secretary Voskuhl stated the firm will first assess operational

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costs, and if necessary, approach its clients for further negotiation, but stressed that the firm remains focused on quality, efficiency, and satisfaction to the customer - even if that means less profit. He also added that there is room for price negotiations, particularly for contracts that run over several years.

¶17. (SBU) Airbus has considered relocating more of its manufacturing operations outside of Europe to combat the weak U.S. currency. In the United States, for example, it is exploring the opportunity to build a production facility in Mobile, Alabama. The company hopes a closer proximity to military installations can increase its bargaining power with customers like the U.S. Air Force for its military carrier, the KC-30 Tanker. Airbus also announced it may relocate some production facilities to Russia and China. Yet even without the currency problem, the firm will need to continuously restructure if it is to meet its goal of becoming a commercially viable enterprise - one free, we can only hope, of massive state support.

¶18. (U) This message has been coordinated with Embassy Berlin and ConGen Munich.
JOHNSON